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In the Supreme Court of the United States

OCTOBER TERM, 1931.

No. 426.

DAVID BURNET, COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

vs.

CHARLES P. LEININGER,
Respondent.

BRIEF OF RESPONDENT
In Opposition to Petition for Writ of Certiorari.

LEVI COOKE,
GEORGE R. BENEMAN,
Union Trust Bldg., Washington, D. C.,
IRWIN N. LOESER,
National City Bank Bldg., Cleveland, O.,
Counsel for Respondent.

THE GATES LEGAL PUBLISHING CO., CLEVELAND, O.

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INDEX.

Statement of Case 1

Argument 2

Appendix 11

Authorities Cited.

Beecher v. Stevens et al., 43 Conn. 587 5

Bettendorf v. Commissioner, 49 Fed. (2d) 173 C. C. A. 8 5

Bing v. Bowers, 26 Fed. (2d) 1017, (22 Fed. (2d) 450) 8

Central Life v. Commissioner, .. Fed. (2d) 4

Commissioner v. Barnes, 30 Fed. (2d) 289 C. C. A. 3rd 8

Commissioner v. Marshall Field, 42 Fed. (2d) 820, 822 6

Copland v. Commissioner, 41 Fed. (2nd), 501 C. C. A. 7th 8

Day v. Stafford, 107 S. W. 433 5

Dickinson v. Commissioner, 23 B. T. A. 1211 8

Eisner v. Macomber, 252 U. S. 189, 207 .....4, 10

Hallahan v. Commissioner, 14 B. T. A. 584, page 596 .. 7

Harris v. Commissioner, 39 Fed. (2d) 546 6

Harvey v. Ford, 83 Mich. 506 5

Hellman v. United States, 44 Fed. (2d) 83 6

Hinshaw v. Commissioner, 16 B. T. A. 1236 8

Home State Bank v. Vandolak et al., 188 Ill. A. 123 ... 5

Kier v. Commissioner, 15 B. T. A. 1114, 1117-8 8

Leydig v. Commissioner, 15 B. T. A. 124, 132, affirmed 43 Fed. (2d) 494 (C. C. A. 10th) 3

Lucas v. Earl, 281 U. S. 111 .....6, 8, 9, 10

Lynch v. Alworth, 267 U. S. 364 9
Meaher v. Cox, 37 Ala. 201 5
Mitchel v. Bowers, 15 Fed. (2d) 287, 289 ..... 5, 6
Nixon et al. v. Nash et al., 12 O. S. 647 5
Parish v. Bainum et al., 306 Ill. 618 5
Parshall v. Commissioner, 7 B. T. A. 318, 321 8
Poe v. Seaborn, 282 U. S. 101 ..... 4, 9
Rosenstiel v. Gray, 112 Ill. 282 ..... 5, 6
Shellabarger v. Commissioner, 38 Fed. (2d) 566, 567, C. C. A. 7 5
Sherk v. First National Bank, 152 S. W. 832 5
Smith-Powers Logging Co. et al. v. Bernitt et al., 237 Fed. 570, 572 5
Stokes et al. v. Stevens et al., 40 Cal. 391 5
Thomas v. Commissioner, 8 B. T. A. 118, 119 8
Wing v. Commissioner, 17 B. T. A. 1028 7
30 *Cyc.* 605 5
Revenue Acts of 1918 and 1921, Section 213(a) 10, 11
Revenue Acts of 1918 and 1921, Section 218(a) 3, 4

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In Opposition to Petition for Writ of Certiorari.

The "Opinions Below" and Jurisdictional facts are as stated by the petitioner.

STATEMENT OF CASE.

The United States Board of Tax Appeals (hereinafter referred to as The Board) made "Findings of Fact" (R. 19-20) from which it appears

(1) Prior to 1920 respondent owned a one-half interest in a partnership known as the Eagle Laundry Company. (R. 19.)

(2) In 1920 respondent entered into a written agreement with his wife, confirmatory of a pre-existing oral agreement, "wherein it was acknowledged that" his "wife had been and was a full equal partner with him *in the interest* in the Eagle Laundry Company." (R. 20.)

(3) "The fact of this transfer (R. 20) was communicated" to the owners of the other half interest in the Laundry Company.

This proceeding, as presented to the Circuit Court of Appeals, involved the single question, the Board having found specifically the foregoing facts, and particularly that respondent's "wife had been and was a full equal partner with him *in*" *his "interest"* in the partnership, was the income attributable to the wife's share her taxable income or that of the respondent? The position of the respondent, sustained by the Circuit Court of Appeals, is that, prior to the agreement of 1920 as found by the Board, the respondent had a vested interest as a partner in the laundry company: that, prior to the accrual of the income here involved he transferred to his wife, according to the findings, a half interest in his vested interest as a partner: and hence, when profits accrued, they were attributable one-half to the respondent's interest and one-half to the interest of his wife—when a check or other medium, evidencing a distribution of partnership profits, was issued and delivered to him and deposited by him in their joint account (R. 20) he was *eo instanti* he received the fund the holder thereof as to one-half in his own right and as to the other half as trustee for his wife: and the latter moiety was his wife's and not his taxable income.

ARGUMENT.

One serious fallacy runs through the petitioner's brief and vitiates its entire argument. It assumes (p. 6) that the 1920 agreement as found by the Board amounted only to a transfer by respondent to his wife of a share of profits—an assignment or gift of income. The agreement in question was far more fundamental. According to the findings it constituted the respondent's wife "a full equal partner with him" in his interest in the laundry company. Hence the court below said in its opinion:

> "We cannot regard this contract as a mere assignment of an interest in future profits 'if, when and as' received. It creates mutual rights and liabilities; it is irrevocable; it creates, at least as between the parties, a vested interest in a property right; and the specified profits and losses were hers, not his."

The rule of law, applicable to the facts, recognized by this Court as well as by the various Circuit Courts of Appeals and the Board, was well stated by the Board in *Leydig v. Commissioner,* 15 B. T. A. 124, 132, affirmed 43 Fed. (2d) 494 (C. C. A. 10th):—

> "The cases * * * are singularly free from conflict as to the principle governing the issue raised. From them we conceive the rule to be that income *per se* cannot be assigned to relieve the assignor of the tax levy, but, where the thing assigned was a property right, real or personal, productive of income, income thereafter arising from such property is income to the assignee by virtue of his ownership."

The petitioner assigns "four reasons for granting the writ" of certiorari which we shall examine briefly.

1. While section 218(a) of the Revenue Acts of 1918 and 1921 did provide that "there shall be included in computing the net income of each partner his distributive share, whether distributed or not, of the net income of the partnership," the court below was right on authority when it said of this provision (R. 32):

> "We do not see that section 218(a) undertakes to fix any policy as to who is to be deemed to receive the income; it merely extends the definition of individual income so as to include undivided partnership profits."

The Sixteenth Amendment to the Constitution was not intended to authorize the taxation of one person on

another's income. Neither does the statute or any section thereof require that such be done. Section 218(a) relied upon by the petitioner did not impose any tax. Section 210 imposed the tax on individuals in the following words:

> "Section 210 * * * there shall be levied * * * upon the net income *of* every individual a * * * tax at the following rates."

The sole purpose of Section 218(a) was to provide that partnerships as such should pay no tax, but rather that the tax due on the profits earned by a partnership whether distributed or not should be paid by the owners of the business in their individual capacities. To tax the respondent upon income in which he had no beneficial interest would run counter to the definition of taxable income laid down by this Court in *Eisner v. Macomber,* 252 U. S. 189, 207 as being "gain * * * derived, that is received or drawn by the recipient *for his separate use, benefit and disposal.*" In *Poe v. Seaborn,* 282 U. S. 101, this Court said:

> "These sections lay a tax upon the net income of every individual. The act goes no farther, and furnishes no other standard or definition of what constitutes an individual's income. The use of the word 'of' denotes ownership. It would be a strained construction, which, in the absence of further definition by Congress, should impute a broader significance to the phrase."

To tax to an individual income not beneficially owned by him would obviously cast grave doubt upon the constitutionality of the statute. As said by the Circuit Court of Appeals (8th) in *Central Life v. Commissioner,** .. Fed. (2d):

> "* * * a cardinal purpose of the income tax laws is to tax the income to the person who has the right or beneficial interest therein, and not to throw the burden

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*Not yet officially reported: decided July 13th, 1931.

upon a mere collector or conduit through whom or which the income passes."

(*Shellabarger v. Commissioner*, 38 Fed. (2d) 566, 567, C. C. A. 7; *Bettendorf v. Commissioner*, 49 Fed. (2d) 173 C. C. A. 8.)

The cases cited by petitioner neither support his claims nor are they in conflict with the decision of the court below in the instant case. *Mitchel v. Bowers*, 15 Fed. (2d) 287 involved an agreement between husband and wife whereby the latter should "be entitled to one-half *of the profits* which shall come to the party of the first part from said firm" (9 Fed. (2d) 415) and furthermore the contract might "be terminated by either party at any time": as stated by the Circuit Court of Appeals in its opinion (15 Fed. (2d) 289): "* * * in any view the provision which allowed him *at his pleasure* to denounce the agreement put the absolute disposition of the profits always within his power." The court distinctly indicated that its decision would have been for the taxpayer had his wife acquired by the agreement any interest legal or *equitable* in the firm assets.

That Mrs. Leininger acquired by the agreement of 1920 either a legal or an equitable interest in the firm assets is clear from a long line of authority *inter alia*:—

Smith-Powers Logging Co. et al. v. Bernitt et al., 237 Fed. 570, 572;
30 *Cyc.* 605;
Meaher v. Cox, 37 Ala. 201;
Rosenstiel v. Gray, 112 Ill. 282;
Harvey v. Ford, 83 Mich. 506;
Nixon et al. v. Nash et al., 12 O. S. 647;
Parish v. Bainum et al., 306 Ill. 618;
Sherk v. First National Bank, 152 S. W. 832;
Day v. Stafford, 107 S. W. 433;
Beecher v. Stevens et al., 43 Conn. 587;
Home State Bank v. Vandolak et al., 188 Ill. A. 123;
Stokes et al. v. Stevens et al., 40 Cal. 391.

In this connection attention is called to the finding (R. 20) that the partners of Mr. Leininger were informed in 1920 of "the fact of this transfer" and that the business continued without protest or further change at least through the tax years here involved, i.e., 1920-1923 inclusive, from which, unquestionably, acquiescence must be inferred as a matter of fact and law. (*Rosenstiel v. Gray* and *Smith-Powers v. Bernitt, supra.*)

Harris v. Commissioner, 39 Fed. (2d) 546, cited by petitioner, was decided directly on the authority of *Mitchel v. Bowers* and, as indicated by the syllabus, involved merely an "assignment of interest *in profits.*" In fact, the Circuit Court of Appeals for the Second Circuit itself clearly defined the intended scope of the cases now cited by petitioner when it said in *Commissioner v. Marshall Field*, 42 Fed. (2d) 820, 822:

> "These (*Mitchel v. Bowers, supra, Harris v. Commissioner, supra,* and *Lucas v. Earl, infra*) were, however, all cases in which, though the instrument affected to convey an existing interest in property, there was none at the time which the law recognized. We do not understand that where there are such, they may not be assigned like other property, or that when they have been, the income is still taxable to the assignor."

To conclude this branch of the discussion we call attention to *Hellman v. United States*, 44 Fed. (2d) 83, wherein the Court of Claims on rehearing reversed a previous decision and held:

> "Defendant contends * * * that plaintiff was bound by the partnership return showing his distributive share * * * Partners may adjust between themselves their distributive share in such proportion and in such manner as they may desire. * * * Bookkeeping entries do not constitute income *unless there is the right of* ownership in the amount disclosed by such entries."

And to a long line of Board and Court cases which condemn the theory urged by petitioner when applied to facts such as those found herein. Typical of such cases is *Wing v. Commissioner,* 17 B. T. A. 1028, wherein the Board said:

> "In this theory it has been overlooked that the identity of the party taxable upon income from a partnership interest is not determined merely by the name in which such interest is held but by the ownership of the corpus of the partnership interest.
>
> "As we view it, the income received by petitioner's wife upon her actual interest in the assets producing such income represented income to her whether she was in law a partner or whether the partnership agreement was under state law inoperative to create as to her a partnership liability. It is clear that even had petitioner's wife not been a party to the contract of partnership and the amount here in controversy been paid to petitioner as a portion of the distributive income of a partnership interest standing in his name alone, he would have received this sum merely as a trustee for her, to whom it would be taxable."

It is noteworthy that the Commissioner formally "acquiesced" in the last cited decision, as did he also in the decision in *Hallahan v. Commissioner,* 14 B. T. A. 584, wherein at page 596 the Board said:

> "Can it be said, merely because they are profits upon a partnership interest standing in petitioner's name, that they are distributable to him and must be included in the net personal income upon which he individually must pay a tax? We have had substantially this same situation presented to us before and have drawn definitely the distinction between these cases of which Ormsby McKnight Mitchel (*Mitchel v. Bowers, supra*) is an example, where the beneficial interest in the income alone has been assigned by the party owning the corpus, and those in which the income is produced by property belonging to two jointly, although the ownership of only one was disclosed and the total

income actually collected by that party, who then accounted to his undisclosed co-partner in interest for the latter's share. In these cases we have held the individual receiving the total income taxable only on the portion in which he individually had the beneficial interest, the portion paid his associate being merely received by him in trust for such party."

Commissioner v. Barnes, 30 Fed. (2d) 289 C. C. A. 3rd;
Parshall v. Commissioner, 7 B. T. A. 318, 321;
Thomas v. Commissioner, 8 B. T. A. 118, 119;
Kier v. Commissioner, 15 B. T. A. 1114, 1117-8;
Hinshaw v. Commissioner, 16 B. T. A. 1236;
Copland v. Commissioner, 41 Fed. (2nd), 501 C. C. A. 7th;
Dickinson v. Commissioner, 23 B. T. A. 1211.

2. The second reason urged for certiorari has already been sufficiently answered above. The findings in the instant case establish that the respondent assigned to his wife—not income alone when and as received—but corpus—namely an interest in his partnership interest—from which the income flowed. And *Bing v. Bowers*, 26 Fed. (2d) 1017, cited by petitioner in this connection, not only specifically points out and recognizes the distinction for which we contend, but also upholds

> "a gift or assignment to members of one's family * * * even though it be for the purpose of cutting down total family income tax * * * as long as the gift or assignment is actual or bona fide" (22 Fed. (2d) 450)

provided the assignment is one of income-producing corpus and not one of future income alone.

3. The decision in the instant case does not at all conflict with the holding of this Court in *Lucas v. Earl*, 281 U. S. 111. The income involved in *Lucas v. Earl* was salary

and fees earned by Earl: no part of the income involved therein consisted of profits or gains resulting or springing from capital, which latter are taxable solely to the person equitably owning the corpus or interest from which the earnings flowed. This Court in *Lucas v. Earl* aptly said with reference to the income involved therein:

> "That seems to us the import of the statute before us and we think that no distinction can be taken according to the motives leading to the arrangement by which the fruits are attributed to a different tree from that on which they grew."

Applying this comment to the instant case, obviously the share of profits paid to petitioner's wife was the "fruit" of her interest in the partnership—whether legal or equitable—and, therefore, taxable only to her. There is no analogy between profits so resulting from the ownership of capital and salaries or fees (as in *Lucas v. Earl*) which latter can flow solely from the personal services of the husband in which the wife could have no participating ownership. Indeed this Court in *Poe v. Seaborn,* 282 U. S. 101, pointed out, as already herein set forth, that the very language of the taxing statute indicates that an individual should be taxed only on income of which he has the "ownership," and, further, said:

> "In the *Earl* case * * * we held that * * * the husband's professional fees, earned in years subsequent to the date of the contract, were his individual income * * *. The very assignment in that case was bottomed on the fact that the earnings would be the husband's property, else there would have been nothing on which it could operate."

4. The Government's theory is, we believe, of the type which Mr. Justice Sutherland had in mind in *Lynch v. Alworth,* 267 U. S. 364, when he said:

> "And the plain, obvious and rational meaning of a statute is always to be preferred to any curious, nar-

row, hidden sense that nothing but the exigency of a hard case and the ingenuity and study of an acute and powerful intellect would discover."

We submit that the peculiar facts (referring especially to the Board's findings) render the question involved herein one of very limited application to other taxpayers. The decision below, upon the facts, is in complete accord with the decisions of this and other courts. To sustain the petitioner's position would be to ignore the definition of income laid down by this Court in *Eisner v. Macomber* (*supra*). Section 213 (a)* of the Revenue Acts of 1918 and 1921, in defining income, speaks of "gains, profits and income * * * growing out of the ownership of * * * property." Clearly the income here in question grew out of property owned by the respondent's wife and was, therefore, her and not his taxable income. Whether the basic agreement as found by the Board, coupled with the knowledge and acquiescence of the other partners, constituted respondent's wife a member of the principal partnership or merely the equitable owner of a half interest in the respondent's interest therein, seems immaterial; on either hypothesis the income allocable to her interest, to paraphrase the words of this Court in *Lucas v. Earl,* was "fruit" which "grew" upon a tree of which she was the owner.

It is respectfully submitted that the decision below upon the specific facts as found is in complete accord with the law as heretofore announced by this Court as well as by the various Circuit Courts of Appeals that have passed upon the question; and that the writ should therefore be denied.

LEVI COOKE,
GEORGE R. BENEMAN,
IRWIN N. LOESER,
Counsel for Respondent.

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*See Appendix.

APPENDIX.

Section 213:

(a) Includes gains, profits, and income derived from salaries, wages, or compensation for personal service * * * of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. The amount of all such items shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under subdivision (b) of section 212, any such amounts are to be properly accounted for as of a different period.

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